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No. ——

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

DONALD B. RICE TIRE COMPANY, INC.,
Petitioner,

v.

MICHELIN TIRE CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

TIMOTHY J. WATERS
ROBERT H. MORSE
GLENN R. REICHARDT
JEFFREY N. MARTIN
PEABODY, RIVLIN, LAMBERT & MEYERS
A Professional Corporation
1150 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 457-1000

GEORGE W. SHAFFER
WILLIAM N. ROGERS
SHAFFER & ROGERS
17 West Jefferson Street
Rockville, Maryland 20850
(301) 279-2100
Counsel for Petitioner

July 24, 1981

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

Manufacturers, in fashioning systems to distribute their products, often opt not only to sell to independent distributors but to act and compete as distributors themselves. At times, the manufacturer-distributor will restrain the competitive activities of its independent distributors, thereby inviting scrutiny under the Sherman Act. Lower court opinions conflict as to the appropriate antitrust standard for reviewing such restraints in a dual distribution context. This case, involving a manufacturer-distributor's termination of a competing independent distributor, presents the following questions:

1. What is the appropriate standard, under Section One of the Sherman Act, 15 U.S.C. § 1, for determining the legality of a restraint of trade resulting from the termination by a manufacturer-distributor of a customer-distributor with which it competes?

2. Should such a restraint be analyzed according to its purpose, as held by the Court below, according to its source, as held by the Court of Appeals for the Fifth Circuit, or according to the competitive relationship of the parties to the restraint, as suggested by the opinions of this Court and held by the Courts of Appeal for the Second and Third Circuits?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Donald B. Rice Tire Company, Inc. petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals for the Fourth Circuit (App. A, *infra*, 1a-3a) was issued on January 12, 1981, and is reported at 638 F.2d 15. The prior decision and order of the trial court sitting in the United States District Court for the District of Maryland (App. D, *infra*, 6a-28a) is reported at 483 F. Supp. 750.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on January 12, 1981. (App. B, *infra*,

4a). A timely request for rehearing was denied on April 28, 1981. (App. C, *infra*, 5a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This petition involves a construction of Section One of the Sherman Antitrust Act, 15 U.S.C. § 1 (1976), which, in pertinent part, provides:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . .

STATEMENT

The petitioner, Donald B. Rice Tire Company, Inc. (hereinafter "Rice"), is an independent tire dealer located in Frederick, Maryland. (App. D, *infra*, 7a). The respondent, Michelin Tire Corporation (hereinafter "Michelin"), is the American component of an international organization that is the world's largest and most experienced manufacturer of radial tires. (App. D, *infra*, 8a). This action arose out of Michelin's termination, in 1977, of its dealer relationship with Rice. (App. D, *infra*, 6a).

Since its origin in 1955, Rice has been a retail tire distributor of numerous brands and types of tires. About 1972, Rice began to engage in large-scale wholesaling of tires to other retail tire dealers, most of which are located in the Baltimore-Washington area. (App. D, *infra*, 7a-8a). During the early 1970's, Michelin encouraged and nurtured the wholesaling activity of Rice and other large Michelin distributors by providing quantity discounts for large volume purchases. (App. D, *infra*, 8a-9a). Between 1972 and 1977, the wholesale portion of Rice's business grew from 25 percent to 80 percent of its total sales. (App. D, *infra*, 7a).

In late 1977 Michelin decided, in conjunction with certain authorized dealers, to eliminate competition from Rice and other aggressive wholesalers, and "to assume primary responsibility for the wholesaling function." (App. D, *infra*, 9a & 11a). At the time of its termination in 1977, Rice was the largest Michelin distributor in the Baltimore-Washington area, and one of the largest Michelin distributors in the nation. (App. D, *infra*, 8a). The District Court found that the terminations of Rice and other aggressive wholesalers threatened "remaining dealers who might contemplate such a [wholesale] sales strategy," and thereby imposed restrictions on the class of customers to which those dealers could sell. (App. D, *infra*, 18a).

By terminating Rice, Michelin eliminated a competing wholesaler that offered authorized Michelin dealers better terms, including price, than were available from Michelin. (App. D, *infra*, 9a). Rice's termination also eliminated the principal source of supply of Michelin tires to many retail dealers in the Baltimore-Washington area to which Michelin would not sell directly. (App. D, *infra*, 9a).

At trial, Rice proved all the pertinent facts that have led other courts to find a horizontal allocation of customers, a *per se* violation of the Sherman Act. The District Court found that Rice had proven the threshold requirement that Michelin engaged in a combination, contract or conspiracy to restrain trade, which restraint was therefore subject to further analysis under Section One of the Sherman Act. (App. D, *infra*, 11a). The District Court further found that the restraint imposed by Michelin "was motivated in large part by Michelin's desire to assume primary responsibility for the wholesaling function." (App. D, *infra*, 9a-10a). These two findings necessarily established that Michelin had engaged in a contract, combination or conspiracy to elim-

inate competition at the wholesale level—a horizontal restraint upon trade.

The District Court acknowledged that horizontal restraints are illegal *per se.* (App. D, *infra*, 12a). However, in a misplaced reliance upon this Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 372 (1967), the District Court reasoned "that in a dual distribution system where the manufacturer is both supplier and competitor, the restraints imposed are to be evaluated as vertical because '[t]he *source* of the restrictions is the manufacturer.'" (App. D, *infra*, 12a) (emphasis supplied). Since the restraint upon large-scale wholesaling was imposed by a manufacturer (Michelin), the District Court scrutinized it as a vertical restraint under the Rule of Reason. After an analysis of the Michelin restraint under the Rule of Reason, the District Court concluded that Michelin had not violated the Sherman Act. (App. D, *infra*, 28a).

In its review of this ruling, the Court of Appeals for the Fourth Circuit adopted the findings and conclusions of the District Court, but explicitly rejected "any implication arising from the district court's discussion of *Schwinn* that a restraint may always be regarded as vertical if it is imposed by the manufacturer." (App. A, *infra*, 3a). However, in place of the "source of restriction" test employed by the District Court, the Court of Appeals adopted an equally erroneous "purpose" test for determining whether a restraint is vertical or horizontal:

> . . . we think it is important to distinguish between a conspiracy among dealers and their supplying manufacturer *for the purpose* of retail price maintenance that would benefit the dealers and one involving the same parties but redounding primarily to the benefit of the manufacturer as a result of increased interbrand competition. A restraint imposed by the former conspiracy would be horizontal in

> nature and *per se* illegal, while one imposed by the latter would be vertical and analyzed under the rule of reason. (App. A, *infra*, 3a) (emphasis supplied).

Like the District Court, the Court of Appeals failed to apply established antitrust analysis under which the vertical or horizontal nature of a restraint is determined by the *competitive relationship* of the parties to the restraint. The Court of Appeals reasoned that because Michelin's restraints were for the perceived purpose of promoting interbrand competition, the restraints were *both* vertical *and* not unlawful under the Rule of Reason.[1]

REASONS FOR GRANTING THE PETITION

I. THE DECISION OF THE COURT BELOW CONFLICTS WITH THE LAW OF THIS COURT CONCERNING THE APPROPRIATE METHOD TO DIFFERENTIATE HORIZONTAL FROM VERTICAL RESTRAINTS OF TRADE.

The threshold issue in analyzing a claim under the Sherman Act is whether the particular restraint or activity under review is to be classified as horizontal or vertical. Horizontal restraints allocating customers or territories among companies at the same level of a market are considered illegal *per se*. *E.g., United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972). However, vertical customer or territorial restraints, involving com-

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[1] The Court of Appeals failed to apply its own unprecedented "*purpose*" test to the facts of this case. If it had done so, it would have concluded that because the Michelin restraint was, in the words of the District Court, "motivated in large part by Michelin's desire to assume primary responsibility for the wholesaling function," (App. D, *infra*, 9a) its purpose was not to increase interbrand competition, but to eliminate intrabrand competition at the wholesale level. Instead, the Court of Appeals simply ignored the District Court's finding about the purpose of Michelin's restraints and reached its own independent finding that the restraints were "for the *purpose* of promoting interbrand competition." (App. A, *infra*, 3a) (emphasis supplied).

panies at different levels within a chain of distribution, are likely to be scrutinized under the Rule of Reason. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). Thus, the classification of a restraint as horizontal or vertical is not only a threshold antitrust issue, but is often determinative of the outcome of a case.

This Court, in *GTE Sylvania*, recognized that "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions. . . ."[2] 433 U.S. at 58 n. 28. These problems are particularly acute in dual distribution systems in which a manufacturer-distributor like Michelin competes with independent distributors such as Rice.[3] A restraint that at first blush might appear to be a vertical customer or territorial restriction, imposed by a manufacturer upon a distributor at a different market level, actually may be a horizontal restriction that impedes competition between firms at the same market level.

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[2] In the recent words of William F. Baxter, Assistant Attorney General in charge of the Antitrust Division, "[i]f there is any major weakness in antitrust doctrine and analysis as it has been applied in recent years, it is the tendency to focus upon general categories of vertical arrangements and behavior without any careful analysis of their horizontal impacts, if any." Baxter, William F., Prepared Statement to the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 97th Cong., 1st Sess. 4 (Apr. 29, 1981).

[3] The state of the law concerning restraints in a dual distribution context—particularly whether such restraints should be judged as horizontal or vertical—is generally regarded as unsettled. *See* ABA ANTITRUST SECTION, MONOGRAPH NO. 2, VERTICAL RESTRICTIONS LIMITING INTRABRAND COMPETITION 2 n.3 (1977), Altschuler, *Sylvania, Vertical Restraints and Dual Distribution*, 25 ANTITRUST BULL. 1 (Apr. 1980), Jinkinson & Foster, *Per Se Rules Against Vertical Restraints: Down But Not Out*, 58 WASH. U. L. Q. 795, 798 (1980); Note, *Antitrust Treatment of Intrabrand Territorial Restraints Within a Dual Distribution System*, 56 TEX. L. REV. 1486 (1978).

This Court has not articulated an analytical framework for characterizing a restraint on competition within a dual distribution system as horizontal or vertical for purposes of Section One of the Sherman Act. However, in other contexts this Court has found that the vertical or horizontal character of a particular restraint should be determined by reference to the *competitive relationship* of the parties, rather than by the *purpose* or *source* of the restraint. As this Court explained in *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305, 313 (1956) (a case which involved characterization of a restraint within a dual distribution context for purposes of "fair trade" statutes), ". . . the crucial inquiry is whether the contracting parties compete with each other . . . at the same functional level."

This Court also applied a "competitive relationship" test in *United States v. Sealy, Inc.*, 388 U.S. 350, 352 (1967), where this Court concluded that substance, rather than form, should be considered in distinguishing horizontal from vertical restraints.[4] Later in *United States v. Topco Associates, Inc.*, 405 U.S. 596, 608 (1972), this Court held that a restraint is horizontal if the parties affected by the restraint are "competitors at the same level of the market structure . . . ." *Topco* was reaffirmed in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. at 57 n.28.

Thus, the "purpose" test adopted by the Court below to distinguish horizontal from vertical restraints con-

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[4] In a June 23, 1981, address to the annual meeting of the District of Columbia Bar, Attorney General William French Smith agreed that restraints which are ostensibly vertical may in fact be horizontal in effect:

> In analyzing any specific vertical arrangement, one must ask whether it has an anticompetitive effect at any identifiable horizontal level. Where vertical arrangements do, we shall seek whatever relief is necessary to eliminate the anticompetitive effects.

flicts with a long line of Supreme Court precedent which makes that distinction turn on the competitive relationship of the parties. Neither this Court nor any other federal court has issued a reported opinion that used "purpose" to determine whether a restraint is vertical or horizontal.

I. THE DECISION OF THE COURT BELOW CONFLICTS WITH THE LAW IN OTHER CIRCUITS CONCERNING THE LEGALITY OF RESTRAINTS IMPOSED BY A MANUFACTURER IN A DUAL DISTRIBUTION SYSTEM.

In the absence of specific guidance from this Court concerning the proper method to distinguish horizontal from vertical restraints within a dual distribution system, sharp conflicts have developed among the Circuit Courts of Appeal on this issue. The Second and Third Circuits[5] have applied a competitive relationship test to conclude that restraints imposed by manufacturers upon competing distributors in dual distribution contexts are horizontal restraints. On the other hand, the Fifth Circuit and the District Court below have con-

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[5] Pitchford v. PEPI, Inc., 531 F.2d 92, 104 (3d Cir.), *cert. denied*, 426 U.S. 935 (1976); American Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230, 1253-54 (3d Cir. 1975), *affirming*, 365 F. Supp. 1073, 1092-93 (D.N.J. 1973); Interphoto Corp. v. Minolta Corp., 295 F. Supp. 711, 721-22 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 (2d Cir. 1969); Copy-Data Systems, Inc. v. Toshiba America, Inc., 1979-1 Trade Cases (CCH) ¶ 62,696, (S.D.N.Y. 1979); United States v. CIBA GEIGY Corp., 1976-1 Trade Cases (CCH) ¶ 60,908 (D.N.J. 1976). The Sixth Circuit has applied a similar test to find that a manufacturer-imposed restraint was horizontal for purposes of the McGuire Act. Rubbermaid, Inc. v. Federal Trade Commission, 575 F.2d 1169, 1174 (6th Cir. 1978).

cluded that such restraints should be analyzed solely as vertical restraints because their "sources" are manufacturers.[6]

The purpose test invented by the Court below is in conflict with *both* of the preceding lines of authority.[7]

The current conflict among the circuits concerning the characterization of restraints as horizontal or vertical may be attributable to the attempt by the lower courts to reconcile *dicta* in this Court's opinion in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), with the analysis dictated by this Court's rulings in *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305 (1956), *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), and *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972).

As described above, *McKesson*, *Sealy* and *Topco* hold that the characterization of a restraint as horizontal or vertical depends upon the competitive relationship of the parties to the restraint. Pages 8-9, *supra*. Unfortunately, some lower courts, including the District Court below and the Fifth Circuit, have misread this Court's opinion in *Schwinn* and erroneously concluded that any restraint

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[6] Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1004-05 (5th Cir. 1981); Donald B. Rice Tire Co. v. Michelin Tire Corp., App. D, *infra*, 12a.

[7] The district courts in the Ninth Circuit have followed yet another approach, under which a restraint in a dual distribution context is viewed as neither horizontal nor vertical, but "as a separate business entity." Krehl v. Baskin-Robbins Ice Cream Co., 1979-2 Trade Cases (CCH) ¶ 62,806, at p. 78,704 (C.D. Cal. 1979). *See* Westpoint Pepperell, Inc. v. Rea, 1980-2 Trade Cases (CCH) ¶ 63,341 (N.D.Cal. 1980) (restraint should be characterized by the "role" in which the manufacturer imposed it).

imposed by a manufacturer upon one of its distributors is a vertical restraint.[8]

For instance, the Fifth Circuit in *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001 (5th Cir. 1981), recently concluded, based on this Court's decision in *Schwinn*, that a restraint imposed by a manufacturer upon a competing distributor in a dual distribution context was vertical because its source was the manufacturer:

> When the manufacturer is the source, the conspiracy is vertical.

637 F.2d at 1004. The District Court below reached a similarly erroneous conclusion, which the Court of Appeals below corrected:

> We must reject, however, any implication arising from the district court's discussion of *Schwinn* that a restraint may always be regarded as vertical if it is imposed by the manufacturer. (App. A, *infra*, 3a).

From a comparison of the two quotations above, it is obvious that the Fourth and Fifth Circuits—in opinions issued within a few weeks of each other—have reached opposite conclusions about the implications of *Schwinn*,

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[8] This Court's opinion in *Schwinn* contains the ambiguous statement that:

> We are here confronted with challenged vertical restrictions as to territory and dealers. The source of the restrictions is the manufacturer.

388 U.S. at 372. From an analysis of the lower court opinion in *Schwinn* and of Justice Stewart's concurring opinion, it is clear that the language quoted above was intended to be a simple statement of fact *and not* a rule of law that restrictions whose source is the manufacturer are necessarily vertical restraints. United States v. Arnold, Schwinn & Co., 237 F. Supp. 323, 343 (N.D. Ill. 1965); 388 U.S. at 390-91. This Court's reference to the fact that the manufacturer was the "source of the restrictions" was only intended to distinguish those particular restrictions from other restraints of a horizontal nature which had been considered by the lower court but were not before this Court on appeal. *See* 388 U.S. at 368, 377.

and its purported "source" test, for the characterization of restraints as horizontal or vertical.

The decision of the Court below also conflicts with the opinions of the Second and Third Courts, which have followed this Court's analysis in *McKesson* by determining the character of restraints imposed by manufacturers in dual distribution systems according to the competitive relationships of the parties to the restraints. *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1254 (3d Cir. 1975) (citing *McKesson*); *Interphoto Corp. v. Minolta Corp.*, 295 F.Supp. 711, 718 n.2 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 (2d Cir. 1969) (citing *McKesson*). The rule in these circuits is that if a manufacturer restricts the competition it faces from independent distributors, the restraint will be considered horizontal and unlawful *per se*. *See American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1253-54 (3d Cir. 1975), *affirming*, 365 F. Supp. 1073, 1092-93 (D.N.J. 1973); *Interphoto Corp. v. Minolta Corp.*, 295 F. Supp. 711, 718 n.2, 720-21 (S.D.N.Y.), *aff'd per curiam*, 417 F.2d 621 (2d Cir. 1969); *Copy-Data Systems, Inc. v. Toshiba America, Inc.*, 1979-1 Trade Cases (CCH) ¶ 62,696 (S.D.N.Y. 1979) (relying upon *Interphoto*).

Other courts outside the Second and Third Circuits have similarly characterized restraints imposed by manufacturers upon competing distributors as horizontal. For example, in *Rubbermaid, Inc. v. Federal Trade Commission*, 575 F.2d 1169, 1174 (6th Cir. 1978), the Sixth Circuit held that a manufacturer's imposition of restraints on independent wholesalers, to prevent them from selling to non-authorized retailers, was a horizontal restraint (for purposes of the McGuire Act) because the manufacturer also operated as a competing wholesaler. *See also Guild Wineries & Distilleries v. J. Sosnick & Son*, 102 Cal. App. 3d 627, 162 Cal. Rptr. 87 (1980).[9]

[9] Until recently, the Fifth Circuit also held that an agreement between a manufacturer and an independent distributor in a dual

By differentiating between horizontal and vertical restraints on the basis of their purpose, the Court below has added to the conflict that exists among the circuits concerning the appropriate framework for analysis of restraints in dual distribution contexts. The Court below did not even consider the applicability of the widely accepted competitive relationship test prescribed by *McKesson* and it expressly rejected the *Schwinn* "source" test recently applied by the Fifth Circuit. As a result, the legality of a restraint imposed by a manufacturer upon a competing distributor in a dual distribution system now depends largely upon the judicial circuit within which that restraint is reviewed.

The conflict among the circuits concerning the characterization of restraints in a dual distribution context is ripe for resolution by this Court. Further delay in this Court's review of this issue could create inequities among litigants in different jurisdictions and add to the unnecessary confusion that exists in the wake of *McKesson* and *Schwinn*. Rice respectfully submits that the instant petition presents an appropriate case for fashioning the appropriate framework for analysis of restraints in a dual distribution system.

III. THE DECISION OF THE COURT BELOW WEAKENS THE UNDERPINNINGS OF *PER SE* RULES OF ILLEGALITY UNDER THE SHERMAN ACT.

The decision of the Court below trespasses beyond the dual distribution context to undermine the validity of several *per se* rules that have long been central to anti-

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distribution context was a horizontal restraint of trade. Hobart Brothers Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894, 899 (5th Cir.), *cert. denied*, 412 U.S. 923 (1973) (following *Interphoto*). However, the Fifth Circuit's more recent opinion in Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001 (5th Cir. 1981), has raised doubt about the continuing validity of *Hobart Brothers* as a rule of law in the Fifth Circuit. *Id.* at 1005.

trust law, particularly the *per se* rule applicable to resale price maintenance.

This Court created *per se* rules of illegality to avoid complicated and costly inquiries into the alleged purposes or business justifications for certain manifestly anti-competitive restraints upon trade. As explained in *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 5 (1958):

> . . . there are certain agreements or practices which . . . are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.[10]

One category of restraints presumed to be unlawful *per se* are customer and territorial allocations among firms competing at the same level of a market. *United States v. Topco Associates, Inc.*, 405 U.S. 596, 612 (1972). The decision of the Court below, by focusing upon "purpose", ignores the reason that horizontal customer and territorial restraints are considered unlawful *per se*. By requiring an analysis of *purpose* to classify such a restraint as horizontal or vertical, the Court below would require precisely the sort of "elaborate inquiry" into purpose or effect that *per se* rules governing horizontal restraints are designed to avoid.

The purpose test of the Court below also undermines traditional *per se* rules of illegality in vertical relationships, particularly the bar against vertical resale price maintenance. The Court below held that a resale price maintenance conspiracy among dealers and their supplying manufacturer should be scrutinized under the Rule of Reason if the benefit of the conspiracy would primarily

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[10] This Court reaffirmed this description of *per se* analysis in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. at 50.

redound to the manufacturer. (App. A, *infra*, 3a). This holding is flatly contrary to this Court's repeated application of a *per se* rule against resale price maintenance. *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102 (1980); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

The "purpose" analysis of the Court below also challenges other traditional *per se* rules governing vertical relationships, including tying arrangements and manufacturer-inspired group boycotts. *E.g., Fortner Enterprises Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969) (tying); *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958) (tying); *Fashion Originators' Guild v. Federal Trade Commission*, 312 U.S. 457 (1941) (group boycott). The opinion of the Court below suggests that if the purposes of such restraints are to benefit the manufacturer, they should be judged under the Rule of Reason.

In sum, the decision of the Court below conflicts with the rationale for *per se* rules of illegality that this Court set forth in *Northern Pacific Railway*, and by so doing has threatened several specific *per se* rules of illegality that this Court has applied to manifestly anticompetitive restraints of trade.

IV. THE DECISION OF THE COURT BELOW RAISES ISSUES OF VITAL CONCERN TO MANY INDUSTRIES THAT EMPLOY DUAL DISTRIBUTION SYSTEMS.

Rice has suffered considerable economic harm as a result of its termination by Michelin. However, a review of the decision by the Court below is not needed simply to redress the injuries suffered by Rice. A review is necessary to preserve healthy competition for all businesses that compete at the wholesale level in dual distribution systems.

Dual distribution systems are common to a significant number of industries, particularly consumer good industries characterized by many retailers. Products distributed through dual distribution networks include, but are not limited to, air-conditioning equipment, apparel, appliances, automobiles, beer, books, candy, drugs, food equipment, footwear, glass, groceries, household goods, lumber, paint, petroleum, plumbing, records, television sets, tires, and tobacco. House Select Comm. on Small Business, The Impact Upon Small Business of Dual Distribution and Related Vertical Integration, H.R. Rep. No. 1943, 88th Cong., 2d Sess. (1964). In the aggregate, wholesale distributors represented more than one trillion dollars of economic activity in 1980. Bureau of Census, U.S. Dept. of Commerce, Revised Monthly Wholesale Trade 1 (1981).

The anticompetitive potential of dual distribution systems, particularly as they affect small businesses, has attracted the concern of Congress. *See, e.g.*, H.R. Rep. No. 1943, *supra*. *See also* Jones, *Marketing Strategy and Government Regulation in Dual Distribution Practices*, 1965-1966 Geo. Wash. L. Rev. 456 (1966). Congress has paid particular attention to the anticompetitive potential of dual distribution in the automotive tire industry. *See, e.g.*, Subcomm. on Retailing, Distribution and Marketing Practices of the Senate Select Comm. on Small Business, 88th Cong., 2d Sess., Studies of Dual Distribution: The Automotive Tire Industry (Comm. Print 1964).

The confusing and conflicting nature of the lower court case law applicable to restraints upon competition within dual distribution systems has created a sense of uncertainty among businesses and their antitrust advisers. *See* Altschuler, *Sylvania, Vertical Restraints, and Dual Distribution*, 25 Antitrust Bull. 1, 102 (Apr. 1980); Panel Discussion, *Sherman Act Implications of Dual*

Distribution, 48 ANTITRUST L. J. 1795 (1979); Note, *Antitrust Treatment of Intrabrand Territorial Restraints Within a Dual Distribution System*, 56 TEX. L. REV. 1486 (1978); *Justice Department Aims at Dual Distribution*, Bus. Week, July 7, 1980, at 24.

There is no suggestion in this Court's opinions that traditional antitrust analysis should be cast aside when restraints occur in a dual distribution system. This Court should take clear and unmistakable action to redirect the disparate paths taken by the lower courts in dual distribution cases back to the appropriate course of antitrust analysis prescribed by this Court in *McKesson* and *Topco*.

CONCLUSION

To resolve conflicting interpretations of a basic issue of antitrust law that directly affects every industry engaged in dual distribution, the petition for a writ of certiorari should be granted.

Respectfully submitted,

TIMOTHY J. WATERS
ROBERT H. MORSE
GLENN R. REICHARDT
JEFFREY N. MARTIN
PEABODY, RIVLIN, LAMBERT
& MEYERS
A Professional Corporation
1150 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 457-1000

GEORGE W. SHAFFER
WILLIAM N. ROGERS
SHAFFER & ROGERS
17 West Jefferson Street
Rockville, Maryland 20850
(301) 279-2100
Counsel for Petitioner

July 24, 1981

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 80-1155

DONALD B. RICE TIRE COMPANY,
(a corporation),
Appellant,

versus

MICHELIN TIRE CORPORATION,
Appellee.

Appeal from the United States District Court
for the District of Maryland, at Baltimore
Joseph H. Young, District Judge

Argued October 8, 1980 Decided January 12, 1981

Before HAYNSWORTH, Chief Judge, BRYAN, Senior Circuit Judge and PHILLIPS, Circuit Judge.

Timothy J. Waters (Robert H. Morse, Glenn R. Reichardt, Peabody, Rivlin, Lambert & Meyers); George W. Shaffer, William N. Rogers, Shaffer & Rogers on brief) for Appellant; Robert P. Knapp, Jr. (Raymond L. Herbert, Bruce N. Morton, William W. Wilbourne, III, Lowe & Knapp; James J. Bierbower, Edwin S. Rockefeller, W. Richard Haddad, Bierbower and Rockefeller on brief) for Appellee.

PER CURIAM:

This is an appeal from a judgment of the United States District Court for the District of Maryland in

favor of defendant Michelin Tire Corporation (Michelin) in an action brought by plaintiff Donald B. Rice Tire Company (Rice) for treble damages for alleged violations of § 1 of the Sherman Act, 15 U.S.C. § 1, resulting from the termination of Rice's dealer relationship with Michelin. At trial, Rice sought to prove that Michelin chose not to renew its dealer sales agreement with Rice because Rice failed to comply with various restraints that it contended were unlawful. Michelin, on the other hand, sought to demonstrate that its decision to terminate Rice constituted unilateral action not within the scope of § 1, that it did not impose the restraints alleged by Rice, and that, if it did, the restraints were legal.

The district court found the "requisite degree of involvement of other parties" to infer a conspiracy under *United States v. Parke Davis & Co.*, 353 U.S. 29, 80 S.Ct. 503, 4 L.Ed.2d 505 (1960), but concluded that any restraints imposed as a result of a conspiracy between Michelin and some of its dealers must be regarded as vertical ones inasmuch as they were imposed by a manufacturer on its dealers. *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. 750, 754 (D. Md. 1980) (relying on *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 856, 18 L.Ed.2d 1249 (1967)). Applying a "rule of reason" analysis with emphasis on a "free rider" rationale, the district court then concluded that any detrimental effect on intrabrand competition resulting from Michelin's imposition of certain vertical nonprice restraints was outweighed by the beneficial effect that those restraints had on interbrand competition. *Id.* at 756-60; *see Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977). Therefore, the district court held that Michelin had not acted in violation of 15 U.S.C. § 1. *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. at 761-62.

We find the ultimate result reached by the district court to be the correct one. We must reject, however,

any implication arising from the district court's discussion of *Schwinn* that a restraint may always be regarded as vertical if it is imposed by the manufacturer. *See id.* at 754. Although the Supreme Court did emphasize in *Schwinn* that the source of the restrictions in that case was the manufacturer, it went on to distinguish the restrictions under consideration from "horizontal restraints, in which the actors are distributors with or without the manufacturer's participation." *United States v. Arnold, Schwinn & Co.*, 388 U.S. at 372, 87 S.Ct. at 1862. Thus we think it is important to distinguish between a conspiracy among dealers and their supplying manufacturer for the purpose of retail price maintenance that would benefit the dealers and one involving the same parties but redounding primarily to the benefit of the manufacturer as a result of increased interbrand competition. A restraint imposed by the former conspiracy would be horizontal in nature and *per se* illegal, while one imposed by the latter would be vertical and analyzed under the rule of reason.

The district court, however, refused to proceed with a functional analysis in the case below in the belief that such an analysis "would merely duplicate some of the necessary steps in the rule of reason analysis." *Donald B. Rice Tire Co. v. Michelin Tire Corp.*, 483 F. Supp. at 754. Since we agree that, on the facts of the instant case, the two inquiries so nearly coincide, we accept the district court's rule of reason discussion, which clearly indicates that the restraints were for the purpose of promoting interbrand competition, as an answer to both questions.

With the foregoing clarification, we affirm the judgment of the district court on the basis of that court's searching and well reasoned opinion. 483 F. Supp. 750 (D. Md. 1980).

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 80-1155

DONALD B. RICE TIRE COMPANY,
(a corporation),
Appellant,

vs.

MICHELIN TIRE CORPORATION,
Appellee.

Appeal from the United States District Court
for the District of Maryland.

This cause came on to be heard on the record from the United States District Court for the District of Maryland, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

/s/ William K. Slate, II
Clerk

Filed Jan. 12, 1981

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 80-1155

DONALD B. RICE TIRE COMPANY, ETC.,
Appellant,

versus

MICHELIN TIRE CORPORATION,
Appellee.

ORDER

Upon consideration of the appellant's petition for rehearing and suggestion for rehearing en banc, and no judge having requested a poll on the suggestion for rehearing en banc,

It is ADJUDGED and ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Phillips with the concurrence of Judge Haynsworth and Judge Bryan.

For the Court,

/s/ William K. Slate, II
Clerk

Filed Apr. 28, 1981

APPENDIX D

UNITED STATES DISTRICT COURT
D. MARYLAND

Civ. No. Y-78-209

DONALD B. RICE TIRE COMPANY, INC.

v.

MICHELIN TIRE CORPORATION

Jan. 30, 1980

George W. Shaffer, William N. Rogers, Rockville, Md., Timothy J. Waters, and Robert H. Morse, Washington, D. C., for plaintiff.

James J. Bierbower, Bethesda, Md., Robert P. Knapp, Jr., and Raymond L. Herbert, New York City, for defendant.

JOSEPH H. YOUNG, District Judge.

Plaintiff Donald B. Rice Tire Company (Rice) sued the Michelin Tire Corporation (Michelin) for treble damages for alleged violations of 15 U.S.C. § 1 resulting from the termination of Rice's dealer relationship with Michelin. At trial, plaintiff sought to prove that defendant chose not to sign a new annual dealer sales agreement because Rice failed to comply with various restraints which Rice contended were unlawful. The defendant sought to demonstrate that its decision to terminate Rice constituted unilateral action not within the scope of § 1, that it did not, in fact, impose the restraints alleged by the plaintiff, and that, in any case, the restraints were legal.

The evidence presented to the Court indicates that defendant's decision does not constitute unilateral action escaping scrutiny under § 1. In addition, the evidence shows that the nonrenewal decision was motivated, at least in part, by defendant's desire to impose various restraints upon its authorized dealers. Plaintiff failed to establish, however, that the overall effect of the contested restraints was anti-competitive and thus that they were unreasonable under *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977). Because this Court's decision turns in large part upon its assessment of the competitive effects of the nonrenewal decision, a brief review of the events leading up to the decision is in order.

Factual Background

The Donald B. Rice Tire Company is an independent tire dealer located in Frederick, Maryland, approximately forty miles from both Washington and Baltimore. The company was founded in 1955. During the late 1960's, Rice began to sell Michelin tires which it bought from an authorized dealer. In 1970, following discussions between Rice and Michelin, a dealer sales agreement (DSA) was signed. The DSA was for a period of a year and subsequent contracts were signed by the parties annually until 1977 when Rice was notified of the nonrenewal decision. During this seven-year period, plaintiff experienced very rapid growth. In 1970, Rice had sales of approximately $500,000, whereas by 1977, sales exceeded $10,000,000. A substantial part of this increase resulted from Rice's decision in 1973 to become a large-scale wholesaler of Michelin tires. The wholesale portion of plaintiff's business, which accounted for less than 25% of total sales in 1972, expanded to the point that in 1977 it represented 80% of Rice's business. Plaintiff was particularly successful in its efforts to wholesale Michelin tires; by 1977, its volume of Michelin sales exceeded

$4,000,000, making it one of the largest Michelin dealers in the country.

Rice took full advantage of discounts offered by Michelin on a per order and annual basis for large volume sales. Employment of this strategy enabled Rice to purchase Michelin tires 15% more cheaply than buyers who were not entitled to any discounts. Rice then wholesaled to smaller authorized dealers and to unauthorized Michelin dealers. Rice's rapid growth was accompanied by a corresponding expansion in the geographical area in which it competed. Whereas in 1972, Rice competed almost exclusively in the geographical area within 150 miles of Frederick, by 1977, approximately 20% of plaintiff's sales were outside the area consisting of Maryland and the states contiguous to it.

Throughout these proceedings, the defendant was much more reticent than the plaintiff in voluntarily revealing information pertaining to corporate organization, strategy, and sales volume. Nevertheless, testimony at trial established Michelin's successful penetration of the American tire market. Although Michelin had developed the steel-belted radial tire during the 1940's and had widely distributed it in Europe during the 1950's, the radial tire, the only type manufactured by Michelin, was not actively promoted in the United States until the latter half of the 1960's. The first significant step in this direction occurred in 1964 when Sears, Roebuck and Company began selling Michelin tires under its private Allstate label.

The next stage in Michelin's drive to penetrate the American market, according to the testimony of dealers and former Michelin employees, consisted of signing large, established dealers who assumed responsibility for introducing and distributing Michelin tires in their geographical areas. These large dealers retailed Michelin tires and also wholesaled them to "associate dealers."

This method of distribution was in part a result of a shortage of trained Michelin sales personnel.

Michelin followed this distribution method until the mid-1970's when it increased the number of authorized Michelin dealers and assumed a greater portion of the wholesaling function. Thus, the number of authorized dealers increased from 300 in 1969 to 2500 in 1977. The change in policy was also reflected in the DSA employed by Michelin. The DSA signed by the parties in 1973 provided that "Dealer may appoint one or more Associate Dealers . . . of good financial standing, business reputation and service capabilities . . . [and] shall notify Seller of every Associate Dealer appointment on a form specified and furnished by Seller." By 1975, this provision had been replaced by the following language: "It is understood that the right to appoint dealers in Michelin brand products is reserved to Seller and the privilege to deal in Michelin brand products is non-exclusive."

As plaintiff's success in wholesaling Michelin tires from 1973 through 1977 indicates, the defendant's attempts to integrate vertically were not entirely successful. Unauthorized dealers, as well as smaller Michelin dealers who could not qualify for the maximum quantity discounts, continued to buy from Rice and other dealers who wholesaled. In addition, even large dealers would buy Michelin tires from Rice when they were unavailable from Michelin. Finally, in late 1977 and early 1978, Michelin decided not to renew Rice and other authorized dealers who extensively and aggressively wholesaled Michelin tires. Although those nonrenewal decisions are not at issue in this case, the fact remains that they cast light upon the defendant's rationale in the instant dispute. The conclusion that the nonrenewal decision in this case was motivated in large part by Michelin's desire to assume primary responsibility for the wholesaling func-

tion is further bolstered by the deposition testimony of Gerard W. Boyle, the President of Englewood Tire Distributors, who stated that the defendant's decision not to renew his dealership agreement was revoked when he offered to terminate his wholesaling activities.

At trial, plaintiff presented evidence of two other forms of restraint imposed by Michelin upon its authorized dealers. First, the DSA contains a location clause limiting the effect of the agreement to the locations specified. This provision was enforced by Michelin's policy of shipping goods to designated locations. In addition, the evidence establishes, and defendant did not contest, that although dealers could pick up tires from the warehouse located in their geographical area, and thereby earn a rebate, they were not permitted to pick up tires from warehouses located elsewhere, even though Michelin would ship tires from nonlocal warehouses in the event of shortages. Plaintiff contended that these policies operated to impede its efforts to compete on a national scale. The economic rationales underlying these restraints as well as the evidence presented concerning the actual competitive consequences of the nonrenewal decision will be examined herein. This analysis is mandated by the Supreme Court's decision in *Sylvania*, which recognized that vertical restrictions might simultaneously suppress intrabrand competition while promoting interbrand competition. *See generally*, ABA Antitrust Section, Monograph No. 2, Vertical Restrictions Limiting Intrabrand Competition (1977).

The Rice Nonrenewal Decision-Unilateral Action or Contract, Combination or Conspiracy in Restraint of Trade

It is necessary to assess defendant's argument that the nonrenewal decision was a unilateral action not subject to scrutiny under 15 U.S.C. § 1 which proscribes "[e]very contract, combination . . . or conspiracy . . . in

restraint of trade . . .," before proceeding to an evaluation of the reasonableness of the restraints imposed by Michelin on its dealers. While a seller "may announce in advance the circumstances under which he will refuse to sell," *United States v. Colgate & Co.*, 250 U.S. 300, 307, 39 S.Ct. 465, 468, 63 L.Ed. 992 (1919), it is not necessary for this Court to find an express or implied contract to conclude that defendant's conduct cannot be characterized as purely unilateral. *United States v. Parke, Davis & Co.*, 362 U.S. 29, 80 S.Ct. 503, 4 L.Ed.2d 505 (1960). Testimony at trial reveals the requisite degree of involvement of other parties.

Jean Pierre Duleyrie, the Vice-President in charge of sales, and the individual primarily responsible for the nonrenewal decision conceded that complaints from Michelin sales personnel in other areas and from other tire dealers about plaintiff's geographically extensive and large-scale wholesaling activities contributed to the decision. While Michelin sales personnel do not qualify as economically distinct entities with whom defendant could conspire or contract, *Fuchs Sugars & Syrups, Inc. v. Amstar Corp.*, 602 F.2d 1025 (2d Cir. 1979), other Michelin tire dealers do qualify. Numerous other witnesses testified that other tire dealers complained to Michelin personnel about plaintiff's activities. In light of this testimony, as well as Duleyrie's concession that no other types of complaints from any sources about any other aspects of plaintiff's business were received prior to the nonrenewal decision, it is apparent that a combination existed for the purposes of § 1 between Michelin and some of its authorized dealers.

Is The Restraint Horizonal or Vertical

Application of the rule of reason standard presupposes that the restraints are vertical. Plaintiff's argument that the restraints should be characterized as horizontal would

require a finding that the restraints are illegal because horizontal restraints are illegal *per se*. *United States v. General Motors Corp.*, 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966); and *United States v. Topco Associates*, 405 U.S. 596, 92 S.Ct. 1126, 31 L.Ed.2d 515 (1972). In support of its contention, plaintiff points to the fact that the parties compete at the wholesale level.

The Supreme Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 372, 87 S.Ct. 1856, 18 L.Ed.2d 1249 (1967) (overruled on other grounds by *Sylvania, supra*), suggests that in a dual distribution system where the manufacturer is both supplier and competitor, the restraints imposed are to be evaluated as vertical because "[t]he source of the restrictions is the manufacturer." Some lower courts, however, have rejected this approach in favor of a functional analysis directed at the impetus, purpose, and effect of the restrictions. *See, e.g., Dougherty v. Continental Oil Co.*, 579 F.2d 954 (5th Cir. 1978); *Rubbermaid, Inc. v. F.T.C.*, 575 F.2d 1169 (6th Cir. 1978); *H & B Equipment Co. v. International Harvester Co.*, 577 F.2d 239 (5th Cir. 1978). This Court rejects the latter approach for a number of reasons. First, the Supreme Court's decision in *Sylvania* clearly indicates that "[*p*]*er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." 433 U.S. at 50, 97 S.Ct. at 2557. Given that the Court in *Sylvania* acknowledged that restraints imposed by manufacturers on sellers may benefit interbrand competition, application of a *per se* rule which does not take those benefits into account, merely because the parties are also competitors, appears to be inappropriate. A more extended functional analysis to determine whether the restraint should be characterized as horizontal or vertical, on the other hand, would merely duplicate some of the necessary steps in the rule of reason analysis because the vertical restraints least likely to promote interbrand competition are those

which are the functional equivalent of horizontal dealer cartels in which the impetus for the restraint is the dealers' interest in higher prices rather than the manufacturer's interest in a more efficient distribution system. Posner, Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Colum.L.Rev. 282, 298 (1975); *Fuchs Sugars, supra*, 602 F.2d at 1030; *Oreck Corp. v. Whirlpool Corp.*, 579 F.2d 126 (2d Cir. 1978). Therefore, a more sensible approach incorporates the horizontal/vertical inquiry into the application of the rule of reason.

Defining the Relevant Market

The relevant market must be defined in order to evaluate the competitive consequences of the restraints at issue in this case. *Gough v. Rossmoor Corp.*, 585 F.2d 381 (9th Cir. 1979). Although the parties have suggested numerous variables bearing on market definition, the task is quite burdensome in the context of this case.

The inquiry will be simplified by articulating at the outset the types of variables that are relevant to market definition. First, it should be noted that the relevant geographic and product markets are defined primarily with reference to cross-elasticity of demand. *Neugebauer v. A. S. Abell Co.*, 474 F.Supp. 1053 (D.Md.1979) (citing *United States v. E. I. duPont de Nemours*, 351 U.S. 377, 76 S.Ct. 994, 100 L.Ed. 1264 (1956)). Defendant's expert witness, Dr. Peter D. Linneman also pointed out that cross-elasticity of supply plays a role in defining the product market. Areeda and Turner, Antitrust Law, Vol. II, 374-376 (1978); *Brown Shoe Co. v. United States*, 370 U.S. 294, 325-26, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). In this connection, he suggested that factors such as common inputs and the ease with which a manufacturer could shift the geographical or product focus of his activities were relevant to market definition.

There is a wide range of possible parameters relating to definition of the product market: brand; use (truck, earth mover, and passenger car tires); construction (radial vs. non-radial); application (original equipment vs. replacement); and newness (new vs. retread). The parties agreed that the product market should be divided according to use and plaintiff contended that Michelin tires should be considered a separate market. Although the evidence clearly established that Michelin is a premium tire with a reputation for durability and safety, these attributes are insufficient under the functional interchangeability test that serves as a proxy for cross-elasticity of demand, to justify such a narrow product market definition. *Neugebauer, supra.*

Defendant's contention that the original equipment and replacement markets should be grouped together is more problematic. As Dr. Linneman suggested, producers can easily shift their activities in these two areas in response to price changes. Customers, however, do not buy vehicles to obtain tires. Therefore, at first glance, there is high cross-elasticity of supply but not of demand. This conclusion rests on the assumption that motor vehicle manufacturers and dealers and vehicle owners are not buyers in the same market. Upon reflection, however, it is necessary to reject this premise in light of the fact that all of these buyers are competing for access to the same products. An increase in demand for tires by automobile manufacturers for example would result in higher prices being charged to both manufacturers and vehicle owners.

More difficult problems of definition are presented by the remaining variables. Initially, it would seem that radial and non-radial tires should be included in the same product market. Much less superficially similar products have been so grouped. In *duPont, supra,* for example, the Supreme Court rejected the contention that

the correct product market was cellophane and held that all flexible wrapping materials should be included. 351 U.S. at 400, 76 S.Ct. at 994. In the replacement tire market, however, radials and non-radials, despite their superficial similarity, are not feasible substitutes unless the customer is replacing all of the tires on his vehicle because consumers are advised that safety reasons militate against mixing radials and non-radials. The conclusion that radials and non-radials are not in the same product market is bolstered by evidence of very significant price differentials between the two types of tires. A 1977 Modern Tire Dealer survey indicated that the median price for bias tires was between $30 and $35 and that bias belted tires averaged $5 more. The median price for radial tires, on the other hand was between $60 and $65. This conclusion is also bolstered by the testimony of the plaintiff's expert witness, Dr. Robert George Cox. Dr. Cox stated that it is difficult to transform plants for the manufacturing of bias and bias-belted tires into facilities for the production of radial tires.

The evidence relevant to new and retread tires also indicates a substantial price differential. Moreover, the production facilities for the two products are totally distinct. Testimony established, however, that there was high cross-elasticity of demand between these two types of products, particularly in the truck tire market. Manufacturers compete on the basis of how many times their radial tires can be retreaded. Numerous tire dealers testified that truck fleet owners were extremely sophisticated buyers who compared tires on the basis of cost per mile. Given this fact, as well as the fact that new and retreaded tires are functionally interchangeable, it follows that new and retread truck tires are in the same product market. Although automobile owners are presumably less expert tire buyers, there is no reason to think that the availability of retreads as a substitute for new tires does not also affect prices charged for new radial tires.

The evidence relevant to definition of the appropriate geographical market suggests that the Baltimore-Washington metropolitan area is the proper benchmark. Areeda and Turner, *supra*, Vol. II at 358, state the general proposition that "[t]wo areas are ordinarily separate markets where there are no or only episodic sales between them and where transport costs exceed any price differentials between the two areas." In this case, the tire dealers who testified, including plaintiff, indicated that the great bulk of their business was in the immediate metropolitan area and that transportation costs generally prevented sales in other areas even where a price differential might exist. The barrier presented by transportation costs is underlined by plaintiff's desire to "drop-ship" tires to distant customers rather than to ship them from plaintiff's establishment in Maryland. The other factors outlined by Areeda and Turner, *supra*, Vo. II at 367, that bear on the definition of the geographical market also support this conclusion. First, "[f]or some products . . . the availability of immediate servicing is of critical importance, and consumers will not buy the product unless immediate servicing is readily available. For other products, the immediate availability of the product itself is important and local distribution facilities are essential to successful marketing. And where consumer goods . . . are concerned, heavy initial promotional expenditures may be necessary successfully to penetrate a particular geographic area . . . ." Thus, the necessity of providing point-of-sale services precludes rapid shifts in supply in response to price changes. This appears to be true in the tire industry. As noted further herein, promotion and service are essential to the efficient marketing of tires.

The Reasonableness of the Restraint

The Court in *Sylvania* recognized a number of types of marketing efficiencies that might result from the man-

ufacturer's imposition of vertical restraints. It pointed out that entrants into a market might use such restrictions "to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer." In addition, "[e]stablished manufacturers can use [such restraints] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products." 433 U.S. at 55, 97 S.Ct. at 2560. Also, the Court noted that developments in products liability law result in greater "demands that manufacturers assume direct responsibility for the safety and quality of their products." *Id.* at n.23. At trial, defendant introduced evidence in support of its contention that the restraints at issue in this case can be justified on all of the grounds enumerated above, thus contesting the plaintiff's evidence that the reasons given were pretextual. As the following review of the evidence will demonstrate, although the first and third contentions are without factual basis, the second contention is supported by the evidence.

The New Entrant Rationale

The evidence introduced by defendant on this point established that it is a relatively new entrant into a highly concentrated market with a relatively small market share. Other evidence established, however, that the restraints on intraband competition were not necessary to induce retailers to carry and promote the Michelin product. First, the evidence suggested that Michelin, as a result of its introduction of the radial tire, and its apparently well-deserved reputation for quality workmanship, had no difficulties finding dealers for its products. On the contrary, several dealers testified as to their difficulties in obtaining a DSA. Testimony of dealers and Michelin sales personnel established that there were frequently shortages of Michelin tires. These facts militate

against the need for offering incentives to dealers to obtain aggressive sales personnel at the retail level. In any case, the Court is skeptical of the validity of this rationale for permitting vertical restraints. As one commentator has suggested, vertical restraints imposed by the manufacturer to attract distributors may be indistinguishable from restraints imposed to implement a dealer cartel. *See* Pitofsky, The *Sylvania* Case: Antitrust Analysis of Non-Price Vertical Restrictions, 78 Colum.L.Rev. 1, 19 (1978). Because dealer cartels are horizontal restraints, subject to *per se* prohibition, their functional equivalents should be strictly evaluated.

The Free-Rider Rationale

The main thrust of defendant's case was to bring it within the second justification for vertical restraints suggested above. Its evidence established that plaintiff did not bear its fair share of the costs of promoting and servicing Michelin tires. The customer restrictions imposed by Michelin in deciding not to renew those dealers who wholesaled extensively, thereby threatening remaining dealers who might contemplate such a sales strategy, were shown to be necessary to prevent free-riding by retailers on the services provided by other dealers. Failure to impose such sanctions would induce dealers to decrease the amount of services offered in order not to be undersold by free-riding dealers. Eventually, "these services might not be provided by retailers . . . despite the fact that each retailer's benefit would be greater if all provided the services than if none did." 433 U.S. at 55, 97 S.Ct. at 2560.

Free-Riding on the Promotional Efforts of Michelin and Other Dealers

Plaintiff was one of the largest Michelin dealers in the country. Its promotional efforts, however, consisted of advertising in the local newspaper and on radio, and in

supplying some promotional materials and information to the dealers to whom it sold. Given this fact, as well as Kenneth Rice's testimony that he wholesaled tires because of the low level of cost involved, it appears that the level of advertising expenditures was not consummate with the sales volume. The evidence suggested a number of ways in which plaintiff was free-riding on the promotional efforts of others.

One of the reasons given by the defendant for the nonrenewal decision was plaintiff's failure to have a Michelin sign outside his business premises. In light of the fact that other dealers did not have signs, that a previous sign had to be removed at the insistence of the local zoning authorities, and that plaintiff had offered to erect a sign on adjacent property, this reason does not appear significant. This conclusion is bolstered by the testimony of Michelin's sales personnel that the lack of a sign was not in itself a sufficiently serious matter justifying nonrenewal.

Of greater concern are the plaintiff's sales to unauthorized Michelin dealers. These dealers, unlike those operating under a DSA were not contractually obligated to "vigorously and aggressively promote the retail sale of Michelin Products." Rather, they were free to reap the benefits of increased demand for Michelin tires generated by the promotional efforts of authorized dealers. Michelin could have reasonably concluded that its authorized dealers, as evidenced by the fact that Michelin's adamount of promotion lest they be undersold by unauthorized dealers, as evidenced by the fact that Michelin's advantage in the radial market stemming from its pioneering role and reputation for quality was apparently declining as other major tire manufacturers developed radial tires of comparable quality and price that were rapidly gaining acceptance. The need for Michelin to respond to this increased competition from other radial

tire manufacturers by expanded promotional efforts is underscored by the testimony of Thomas Pumpelly, president of National Tire Wholesalers to the effect that Michelin has recently changed its discount policy so that quantity discounts are conditioned on dealers spending 3% on advertising.

The fact that Michelin has changed its discount policy to directly require a certain level of expenditures from retailers desiring quantity discounts raises questions concerning the possible overbreadth of the means used to remedy plaintiff's free-riding. Application of the rule of reason does require an inquiry into whether the restraint is "reasonably necessary." *Newbury v. Washington Post Co.*, 438 F.Supp. 470 (D.D.C. 1977); *Eiberger v. Sony Corp.*, 459 F.Supp. 1276, 1282 (S.D.N.Y. 1978). Pitofsky, *supra*, suggests that such scrutiny is useful to illuminate the true purpose of a restriction. A poor fit between means and ends suggests that the avowed purpose is merely a pretext. Given the fact that plaintiff did not restrict his wholesaling efforts to the immediate geographical market, it cannot be said that the means used were not reasonably necessary. Requiring the plaintiff to spend the specified amount for advertising to qualify for the quantity discount might be ineffective if the promotional efforts and the retail sales were not in the same geographical market, or even if the promotional efforts were merely undertaken by a dealer other than the ultimate retailer of the tire.

Free-Riding on the Services Provided by Other Authorized Dealers

Defendant introduced evidence concerning the important role of service in marketing Michelin tires. Duleyrie testified that service was especially important in the truck tire market. Proper selection of tires for truck fleets depends on the size of the tire, choice of ply rating,

variance in the loads to be carried, and the speeds at which, and road surfaces upon which, the truck would be driven. He also stated that repairing and retreading services were important. Dr. Ira Robert Ehrlich, the defendant's expert witness in the field of tire engineering also asserted that service of Michelin tires required specialized knowledge. Tire selection, according to Dr. Ehrlich, also depends on the types of tube and rim involved. In addition, different brands of tires have different inflation specifications. Alexander Jankowsky, the national truck tire sales manager for Michelin, testified that Michelin recommended different methods of repairing and retreading from those endorsed by other manufacturers. Michelin also differed in its recommendations concerning balancing methods and use of sealants. From this evidence, the Court concludes that Michelin had a legitimate interest in ensuring that tires were sold by dealers who could provide these specialized services. This conclusion is buttressed by the provision in the DSA requiring that the dealer "render prompt, workmanlike and courteous service with respect to Michelin Products including all services to which a purchaser of a Michelin Product from any authorized Michelin source may be entitled." Several dealers testified that they had difficulty obtaining DSA's as a result of their lack of service facilities.

At trial, defendant attempted to show that plaintiff's own service facilities were inadequate. This attempt failed in light of the unanimity of opinion among witnesses for both parties that plaintiff's service facilities were adequate, and that no complaints have ever been received concerning services rendered. The evidence with respect to plaintiff's facilities did establish that the volume of services performed was not commensurate with the volume of Michelin tires sold by plaintiff. This fact was conceded to be a function of plaintiff's wholesaling activities.

Several cases have recognized the manufacturer's legitimate interest in ensuring the provision of point-of-sale services. *See, e.g., Golden Gate Acceptance Corp. v. General Motors*, 597 F.2d 676 (9th Cir. 1979); and *Eiberger, supra.* The economic argument, as outlined in Posner, *supra*, at 283-85, is that if manufacturers are not permitted to impose vertical restraints which have the effect of stimulating point-of-sale services, dealers will not provide these services lest they be undercut by dealers not providing services. The problem is particularly acute in markets wherein it is difficult to prevent customers from obtaining services at one location while purchasing products from another outlet that does not offer the services but does offer lower prices.

The evidence at trial established that plaintiff's sales to unauthorized dealers were creating such problems. Duleyrie testified of an instance in which a truck fleet owner (user) had purchased Michelin tires from an unauthorized dealer. This user had not received the proper assistance in selection and application of the tires. Although the tires were not defective, Michelin had to make commercial concessions to avoid losing the account. Although Duleyrie conceded that the tires in question were not traced to Rice, it is reasonable to conclude that Rice's wholesaling activities created the risk that this type of problem would occur.

As the DSA indicates, Michelin dealers are obligated to service Michelin tires. Customers who bought Michelin tires from unauthorized dealers who were not so obligated presumably went to authorized dealers to obtain service. Brent Rigby, who formerly served as district manager for the Baltimore district, testified that dealers resent having to service tires that they did not sell. This fact was conceded by a number of tire dealers and suggests that the free-rider problems set out earlier existed and that Michelin reasonably could have determined that

nonrenewal of major wholesalers was necessary to ensure provision of point-of-sale services.

Robert M. Johnson, Vice President of Rice, testified that the company took care of adjustments for defective tires sold to other dealers and indicated that Michelin's sales representative had classified Rice's number of adjustments as average. However, this does not prove that customers were, or were not, receiving adequate assistance in selection, application, maintenance and repair for tires purchased from unauthorized dealers who had purchased from Rice. Plaintiff's reliance upon Michelin's policy of tolerating wholesaling to small dealers is also misplaced. This policy probably resulted from a realization that such wholesaling was a universal practice. Michelin, with good reason, could have concluded that the costs of enforcing a ban on such wholesaling exceeded any gain to be derived from enforcement. Although some courts have strictly scrutinized the means employed by a manufacturer to achieve an admittedly legitimate objective, *see, e.g., Eiberger, supra*, the Court should not second-guess a manufacturer's choice from a range of alternative strategies.

The other evidence introduced by plaintiff to show that the service rationale was a pretext was the testimony of one dealer that the local Michelin sales representative suggested that he establish a sham retail operation in order to maintain his wholesale business in Michelin tires. This evidence, however, does not undermine the Court's conclusion that Michelin management was concerned about the services received by purchasers of its products. Sales personnel employed by Michelin earned commissions on tires sold to dealers in their areas. This arrangement clearly resulted in such personnel adopting a protective attitude towards the authorized dealers in their areas and was also responsible for the fact that sales personnel had a disincentive to report any inadequacies in the services offered by dealers in their area.

This fact supports the necessity of Michelin management taking steps to ensure provision of point-of-sale services.

Territorial Restrictions

At trial, plaintiff introduced evidence that Michelin imposed territorial as well as customer restrictions on its authorized dealers. These territorial restrictions took the form of location clauses in the DSA and in the institution of a warehouse policy. Testimony established that the location clause was designed to ensure that authorized dealers only sold Michelin tires at locations at which they could provide services. The warehouse policy in effect barred dealers from picking up tires at warehouses not located in their district. They were permitted to pick up tires at the local warehouse and thereby earn a discount. In addition, if tires were unavailable at the local warehouse, Michelin would ship the tires to the dealer. Dr. Linneman suggested a persuasive economic rationale for this practice. Michelin presumably warehoused tires at the various regional warehouses in accordance with its forecasts concerning anticipated demand for Michelin tires in the area. Permitting dealers to pick up tires from any warehouse would make such planning more expensive. Dr. Linneman did concede, however, that the rationale underlying this policy did not apply when the customer was located in the district served by the warehouse, as its needs were presumably taken into account in supplying inventory for that warehouse. In evaluating the legality of this particular restraint, the Court is aware that "the fact that no competitive benefits are advanced in favor of a restraint . . . does not automatically constitute it unreasonable. . . ." *Gough v. Rossmoor Corp.*, 585 F.2d 381 (9th Cir. 1979). The plaintiff has the burden of establishing that the restraint actually harmed competition. The actual competitive consequences of the restraints at issue will be

evaluated herein. First, however, the safety rationale must be considered.

The Safety Rationale

Duleyrie testified that one of the reasons behind plaintiff's nonrenewal was the fact that only 4% of the registration cards required by the Department of Transportation had been filed with Michelin for tires sold by Michelin to Rice. The validity of this rationale is undercut, however, by the fact that defendant had received no complaints concerning Rice's handling of the DOT cards. More importantly, numerous witnesses including Edward H. Wallace, the former Chief of the Tire Division at DOT, testified that he wrote the specifications for the registration program and that the wholesaler's duty was to supply the cards to the retailer and that it was the retailer's responsibility to submit them to the manufacturer when the tire was sold to the ultimate consumer. Kenneth Rice testified that he complied with his obligation as a wholesaler. The defendant offered no evidence to rebut this testimony. Therefore, the Court concludes that despite the fact that there is precedent for upholding vertical restrictions designed to promote safety, *Tripoli Co. v. Wella Corp.*, 425 F.2d 932 (3rd Cir. 1970), this case does not fall within that rationale.

Effects of the Restraints on Intrabrand and Interbrand Competition

The benefits to interbrand competition expected to result from the vertical restraints imposed by Michelin upon its dealers have been discussed. However, the rule of reason standard requires an assessment of the potential detriment to intrabrand competition of the challenged restraints.

Several authors have suggested a structural approach to this problem. See Louis, Vertical Distribution Re-

straints After *Sylvania:* A Postscript and Comment, 76 Mich.L.Rev. 265 (1977) and Pitofsky, *supra.* Generally, the greater the interbrand competition, the less effective vertical restraints will be in limiting intrabrand competition because dealers in a very competitive industry are constrained by competition from sellers of other brands. *Cf. H & B Equipment Co. v. International Harvester Co.*, 577 F.2d 239 (5th Cir. 1978). In addition, the greater the degree of product differentiation, the greater the potential for restriction of intrabrand competition. *See e.g., Westman Commission Co. v. Hobart Corp*, 461 F.Supp. 627 (D.Colo. 1978). Finally, under most circumstances, the manufacturer will have an interest in maintaining intrabrand competition because dealer competition in price and services should increase demand for the manufacturer's product.

As stated above, this Court has reached the conclusion that the appropriate product markets are the radial car tire market, the radial truck tire market, and the radial off-the-road vehicle tire market. In each case, the original equipment and retread segments of the market are included. Although the Court concluded that the relevant geographic market is the Baltimore-Washington metropolitan area, it must rely upon figures pertaining to national market share as they are the only available figures. Dr. Linneman testified that Michelin's share of the radial passenger tire market was 7.9% in 1977, the year of plaintiff's nonrenewal. Michelin's share of the radial truck tire market was more difficult for the experts to calculate as less detailed information was available. Dr. Cox testified, however, that he estimated Michelin's share of that market was approximately 20 to 25%. No figures were available for off-the-road tires, but that market was not the primary focus of the case. Needless to say, the parties' experts disagree as to whether Michelin's market share was large enough to give it market power. An examination of the other

variables bearing on this question indicates that it was not.

Market power is defined as the ability of a producer to raise and sustain prices above the competitive market. Only a firm with market power can effectively restrain competition. While Michelin may have had such power in the late 1960's when it was the sole supplier of radial tires, the presence of larger producers of radial tires of comparable quality and price negates the inference that this was the case in 1977. The conclusion that Michelin lacked the requisite market power to restrain competition is supported by the testimony of numerous witnesses that competition in the industry was fierce, and by the lack of anything other than impressionistic evidence to support plaintiff's contention that Michelin was able to charge consistently higher prices for its products. Rather, Dr. Linneman's study of advertised passenger car tire prices in the Baltimore-Washington area established that during the latter half of the 1970's Michelin advertised prices declined in relation to those of other manufacturers, and were in fact lower than those of at least one of its competitors. In addition, the study showed advertised Michelin prices falling in real dollar terms during the period following plaintiff's nonrenewal. In fact, these downward trends accelerated after plaintiff's nonrenewal.

Although a similar study in the truck tire area would have been useful, as that was the market in which Michelin had a greater market share, the fact remains that plaintiff did not introduce any evidence to establish that this price study did not accurately reflect the realities of the market. Plaintiff failed to meet its burden of establishing that the defendant's actions had anticompetitive consequences.

The plaintiff's explanation of the rationale underlying defendant's conduct is open to question on other grounds.

Plaintiff suggested that defendant was motivated by a desire to eliminate plaintiff as a competitor at the wholesale stage of distribution but did not offer any convincing explanation of why defendant would not prefer to utilize plaintiff's services if plaintiff was in fact a more efficient wholesaler. Presumably, lower wholesale costs would lead to great demand for Michelin products and higher profits. Plaintiff's explanation is also not credible in light of the significant steps taken by defendant to increase intrabrand competition. The evidence established that Michelin deliberately expanded the number of retail outlets authorized to carry its products. Although it may be possible for a manufacturer to restrict intrabrand competition to protect existing dealers, *see, e.g., Westman Commission, supra,* this motivation was not at work in this case. Not only did Michelin increase the number of outlets, numerous dealers testified that Michelin had taken deliberate action to dismantle the system of exclusive geographic territories it had established during the 1960's. Thus, the vertical restraints imposed by Michelin were reasonably necessary to meet the fierce competition from other producers of radial tires and the plaintiff failed to show that Michelin's change in distribution strategies had adverse impacts on intrabrand competition.

The findings of fact and conclusions of law stated herein are in accordance with the provisions of Rule 52, F.R.Civ.P. whether or not specifically stated.

Accordingly, for the reasons stated herein, it is this 30th day of January, 1980, by the United States District Court for the District of Maryland, ORDERED: that Judgment BE, and the same is, hereby entered in favor of the defendant.